Study H-403 September 28, 2009

Memorandum 2009-43

Marketable Record Title: Notice of Option (Comments on Tentative Recommendation)

The "Marketable Record Title Act" (Civ. Code §§ 880.020-886.050), was enacted to implement a Commission recommendation on *Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401 (1982). See 1982 Cal. Stat. ch 1268.

A general purpose of the Act was to enhance the marketability of real property by making the status of recorded title determinable, to the extent practicable, from title records alone. See Section 880.020(b). The ability to establish clear title, solely on the basis of information in the title records, facilitates the issuance of title insurance, which is essential to marketability.

The Commission has learned of an apparent gap in the coverage of Section 884.010. That section provides for the expiration, by operation of law, of obsolete record notice of an option to purchase real property:

> 884.010. If a recorded instrument creates or gives constructive notice of an option to purchase real property, the option expires of record if no conveyance, contract, or other instrument that gives notice of exercise or extends the option is recorded within the following times:
>
> (a) Six months after the option expires according to its terms.
>
> (b) If the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

Without such a provision, record notice of an option to purchase real property could remain as a cloud on title long after the ability to exercise the option has lapsed.

The problem with Section 884.010 is that its operation depends on information that may not be included in the recorded instrument giving notice of an option — the expiration date of the option.

If expiration date information is not included in the record notice, a title researcher would not have the information necessary to determine whether the notice of the option has expired pursuant to Section 884.010. To make that determination, the researcher would need to look beyond the title records to determine the expiration date of the option. That would defeat the purpose of Section 884.010.

The Commission developed and circulated a tentative recommendation that proposed a simple solution to this problem. Section 884.010 would be amended so that it operates entirely on the basis of information that is ascertainable from the recorded instrument:

> **Civ. Code § 884.010 (amended). Notice of option to purchase real property**
>
> 884.010. If a recorded instrument creates or gives constructive notice of an option to purchase real property, the option expires of record if no conveyance, contract, or other instrument that gives notice of exercise or extends the option is recorded within the following times:
>
> (a) ~~Six~~ If the expiration date of the option is ascertainable from the recorded instrument, six months after ~~the option expires according to its terms~~ that expiration date.
>
> (b) If the expiration date of the option is not ascertainable from the recorded instrument or the recorded instrument indicates that the option provides no expiration date, six months after the date the instrument that creates or gives constructive notice of the option is recorded.

The Commission has received two communications commenting on the proposed law. They are attached as an Exhibit, as follows:

SUPPORT FOR PROPOSED REFORM

Attorney Jack Quirk first brought the issue addressed by this study to the Commission's attention. He writes that the proposed reform appears to be "a straightforward fix" for the problem. See Exhibit p. 1. He goes on to suggest that the Commission examine another provision of the Marketable Record Title Act, which he believes presents similar problems. That suggestion is discussed below.

Anthony Helton writes on behalf of the California Land Title Association ("CLTA"), which represents the title insurance industry in California. Mr. Helton writes that "CLTA is supportive of the proposal, and agrees with the CLRC's suggestion to make it prospective." See Exhibit p. 2.

That support is encouraging, as Mr. Quirk and CLTA represent those who practice in this area and who would be directly affected by the proposed law. **The staff recommends that the Commission approve the proposed law as a final recommendation.**

Commenter suggestions for further reforms are discussed below.

EFFECTIVE PERIOD

Both existing law and the proposed law provide that record notice of an option to purchase real property remains effective as notice *six months* after the expiration date of the option (or if there is no expiration date, after recordation of the instrument creating record notice). That provides time for the option holder to record new notice indicating that the option has been extended or exercised, before the original notice expires.

CLTA suggests extending the six-month period to three years:

> We would, however, like to suggest that the period of 6 months set forth in the proposal is too short, and that three years would be more reasonable. Such a period of time would provide enough opportunity for the optionee to investigate the feasibility of exercising the option.

See Exhibit p. 2.

The adequacy of the existing six-month effective period was discussed at length in Memorandum 2009-25 and its First Supplement. As explained there, the effective period used to be one year, but was shortened to six months on the Commission's recommendation. The Commission explained:

> The apparent function of the one-year cloud after expiration of an option is to allow the option holder sufficient time to record an exercise or extension of the option that occurs at the end of the term of the option. For this purpose, one year is excessive; six months should be sufficient.

Marketable Title of Real Property, 16 Cal. L. Revision Comm'n Reports 401, 412 (1982) (footnotes omitted).

Six months is also the effective period specified in the Uniform Simplification of Land Transfers Act, which provides for expiration of record notice of an option to purchase real property six months after the "recorded expiration date (or, if there is no recorded expiration date, the date of recording)…." Unif. Simplification of Land Transfers Act § 3-206 (1976).

Furthermore, a six-month effective period appears to be consistent with the prevailing national case law on how long an option without an express expiration date remains enforceable:

> [The] courts have unmistakably tended to uphold as reasonable time intervals of less than six months and to characterize as unreasonable time intervals of six months or more. Irrespective of the circumstances involved, the number of cases in which intervals of less than a half-year were found to be unreasonable have been disproportionately few, as have, by an even more impressive ratio, the number of cases in which longer intervals were held to be reasonable.

87 A.L.R. 3d 805, § 2 (footnotes omitted). See also 60 Am. Jur. Proof of Facts 3d 255, § 16 (2008) ("courts have shown an unmistakable tendency to uphold as reasonable nearly all intervals of less than six months and to find unreasonable nearly all intervals of six months or more, regardless of the factual circumstances on which the various rulings were based.")

To the extent that trend holds true in California, the existing six-month rule would provide a period of record notice that matches the probable effective period of an open-ended option. In the unusual case that a longer period of record notice is required, the option holder could record a new notice before the expiration of the first notice.

Considering that the six-month period has been the law in California for over 25 years, **the staff is inclined against changing that period without clear evidence that it is causing problems.** That said, CLTA (or any other interested person) is invited to provide more information on this issue.

UNPERFORMED CONTRACTS FOR SALE OF REAL PROPERTY

Mr. Quirk has suggested that the Commission should examine another part of the Marketable Record Title Act, which may also have problems with reliance on off-record information. His specific concerns are discussed below.

Background

The Marketable Record Title Act addresses a number of different types of real property interests of record. One type of interest addressed by the Act is a recorded contract for purchase of real property. See Civ. Code §§ 886.010-886.050.

For the purposes of those provisions, "contract for sale of real property" is defined as follows:

> "Contract for sale of real property" means an agreement wherein one party agrees to convey title to real property to another party upon the satisfaction of specified conditions set forth in the contract and which requires conveyance of title within one year from the date of formation of the contract, whether designated in the agreement a "contract for sale of real property," "land sale contract," "deposit receipt," "agreement for sale," "agreement to convey," or otherwise.

Civ. Code § 886.010(a). If notice of such a contract is recorded, it acts as record notice of the transferee's interest in the property. Such notice could create a cloud on title that persists after the contract itself has become unenforceable.

The Marketable Record Title Act addresses that problem in two different ways. First, a transferor may demand "a release of the contract, duly acknowledged for record" from a transferee who has not performed as required by the contract. Civ. Code § 886.020. Failure to comply with such a demand exposes the transferee to liability for "the damages the party who agreed to convey title sustains by reason of the violation, including but not limited to court costs and reasonable attorney's fees in an action to clear title to the real property." *Id.* This provides a mechanism that the transferor can use to clear the cloud created by the recorded contract, without court proceedings.

Second, the statute provides for the expiration of record notice of the contract, by operation of law, after a given period of time. This removes the cloud on title by passage of time alone, thus:

> **Civ. Code § 886.030. Expiration of notice**
>
> (a) Except as otherwise provided in this section, a recorded contract for sale of real property expires of record at the later of the following times:
>
> (1) Five years after the date for conveyance of title provided in the contract or, if no date for conveyance of title is provided in the contract, five years after the last date provided in the contract for satisfaction of the specified conditions set forth in the contract.
>
> (2) If there is a recorded extension of the contract within the time prescribed in paragraph (1), five years after the date for

conveyance of title provided in the extension or, if no date for conveyance of title is provided in the extension, five years after the last date provided in the extension for satisfaction of the specified conditions set forth in the contract.

(b) The time prescribed in this section may be waived or extended only by an instrument that is recorded before expiration of the prescribed times.

Civ. Code § 886.040. Effect of expiration of notice

Upon the expiration of record of a recorded contract for sale of real property pursuant to this chapter, the contract has no effect, and does not constitute an encumbrance or cloud, on the title to the real property as against a person other than a party to the contract.

As can be seen, this is very similar to the approach taken with respect to record notice of an option to purchase real property. In each case, the statute provides a definite effective period, based on trigger dates that should be included in the record notice itself. After that effective period has passed, the notice becomes ineffective as notice and the cloud on title is lifted.

Mr. Quirk's specific concerns about this statutory scheme are discussed below.

One-Year Limitation

The definition of "contract for sale of real property" is limited to a contract that requires conveyance of the property "within one year from the date of formation of the contract…." Civ. Code § 886.010.

Mr. Quirk questions the need for that limitation, which he sees as an invitation to "chicanery." See Exhibit p. 1.

In its recommendation, the Commission explained that the one-year limitation serves to distinguish a contract for sale of real property from an "installment land contract." *Marketable Title of Real Property*, 16 Cal. L. Revision Comm'n Reports 401, 424 (1982).

The Commission also noted that the distinction between a short term contract for sale of real property and an installment land contract exists elsewhere in the general law governing real property transfers. See Bus. & Prof. Code § 10029 ("real property sales contracts" for purposes of Real Estate Law); Civ. Code § 2985 (real property sales contracts), 2985.51 (real property sales contract for subdivided land).

Since the one-year limitation is the basis for a well-established terminological distinction used in real estate law, and there is no indication that it is causing any

problems in practice, **the staff recommends against making any change to the limitation.**

Off-Record Information

Mr. Quirk is concerned that the statute governing the effect of a recorded contract for sale of real property may present the same general problem that exists in the option provisions. That is, the effective period of record notice may depend on information that is not included in the recorded instrument.

His concern appears to be based on use of the term of art "recorded contract for sale of real property," which is defined as follows:

> "Recorded contract for sale of real property" includes the entire terms of a contract for sale of real property that is recorded in its entirety or is evidenced by a recorded memorandum or short form of the contract.

Civ. Code § 886.010(b).

The concern seems to be that use of a "memorandum" to establish record notice of the contract could be problematic, if the memorandum does not include the information required to determine the effective period of record notice (i.e., the "date for conveyance of title provided in the contract," or if there is no such date provided in the contract, the "last date provided in the contract for satisfaction of the specified conditions set forth in the contract.") See Section 886.030(a)(1).

Section 886.010(b) seems to have been drafted to avoid that problem. It defines the term "recorded contract for sale of real property" as including the "*entire terms*" of the contract, regardless of whether those terms are evidenced by a recorded copy of a complete contract, a memorandum, or a short form contract. So even if a memorandum is used to create record notice of the contract, the law would seem to require that the memorandum include the entire terms of the contract (which necessarily includes the terms at issue in Section 886.030). Provided that Section 886.010 is understood and followed, there shouldn't be any problem with reliance on off-record information in this case.

If, however, the definition is not understood, an incomplete notice could be recorded. That could cause uncertainty as to the effect of the instrument. It would be better to avoid such misunderstanding.

The statute could perhaps be phrased more clearly, with the "entire contents" requirement stated more directly, thus:

"Recorded contract for sale of real property" means a recorded instrument that includes the entire terms of a contract for sale of real property ~~that is recorded in its entirety or is evidenced by a recorded~~ , whether the recorded instrument is the complete contract, a short form of the contract, or a memorandum ~~or short form~~ of the contract.

The staff is of a mixed mind about making such a change as part of the current study. On the one hand, the proposed language would seem to be consistent with the existing definition, and it might clear up some potential for misunderstanding. On the other hand, it is not clear that the existing statute (which was drafted by the Commission) is actually causing significant problems in practice.

Furthermore, the scope of this study was framed quite narrowly, to fix a specific problem in the statute governing record notice of an option to purchase real property. The change discussed here would broaden that scope (and could potentially lead to further broadening if other possible technical problems were discovered in the course of investigating the contract provisions). Given the demands on the Commission's time and resources, it is not clear that we should be probing into new areas that are not plainly causing problems.

In addition, if the Commission were to decide to look more broadly at other provisions of the Marketable Record Title Act, it seems likely that legislation to implement the "quick fix" of the option statute would be deferred for another year.

CONCLUSION

The staff agrees with Mr. Quirk that the proposed law would be a straightforward solution to the problem addressed in this study. The proposal is supported by CLTA, the industry group that is most likely to be affected by the proposed change. There is no opposition. For those reasons, **the staff recommends that the Commission approve the proposed law as a final recommendation.**

The staff recommends against changing the existing (and long-standing) six month effective period, barring some evidence that the existing time period has been causing problems.

The staff also recommends against changing the one-year limitation in the existing definition of "contract for sale of real property." That limitation

reflects an existing terminological distinction that is well established in real estate law. There is no evidence that the limitation is causing any problems.

Finally, the staff is not sure whether to propose a change to the definition of "recorded contract for sale of real property," along the lines discussed above. On the one hand, the changes seems innocuous and would probably help to further proper understanding and implementation of the law. If the Commission finds the proposed revision acceptable, it would be a relatively simple matter to solicit comment from interested persons and bring a revised recommendation back for approval at the December 2009 meeting.

On the other hand, it isn't clear that the existing law is causing actual problems in practice, the proposed clarification may not be as simple as it appears, and the staff is leery of getting drawn into a broader search for technical problems that may or may not exist.

Respectfully submitted,

Brian Hebert
Executive Secretary

EMAIL FROM JACK QUIRK
(JULY 28, 2009)

Subject: Re: CLRC Proposal on Marketable Record Title

Mr. Hebert--Seems to me like a straightforward fix.

Also, I have not faced a problem with it but it seems to me that "Unperformed Contracts for Sale of Real Property" (ch. 6, sec. 886.010, et seq.) both (a) has a similar problem in sec. 886.030 as to whether the relevant information is required to be reflected in the record or review of "off-record" material is required and (b) and has a further potential difficulty in the def. of "contract for sale of real property" in sec. 886.010(a), which includes the specific element that the contract "requires conveyance of title within one year of the date of formation of the contract." This makes the statute inapplicable to a contract that must be performed within 370 days of formation, etc. That seems like a pretty slight distinction to take a contract out of the statute (and an invitation to chicanery). Since expiration of record is not going to affect obligations under the contract between the original parties (sec. 886.040), why not just put the onus on the person who records to ensure that an outside date for performance is reflected in the recorded document and provide for expiration of record either 5 years after that date or 5 years after recording is no such date appears in the record.

Thanks for your interest in this,

Jack Quirk

EMAIL FROM ANTHONY HELTON, CALIFORNIA LAND TITLE ASSOCIATION (AUGUST 7, 2009)

The CLTA is supportive of the proposal, and agrees with the CLRC's suggestion to make it prospective. We would, however, like to suggest that the period of 6 months set forth in the proposal is too short, and that three years would be more reasonable. Such a period of time would provide enough opportunity for the optionee to investigate the feasibility of exercising the option.

Thank you for your time and consideration, Brian. If you have any questions or if the above comments seem unclear out of context, please feel free to contact me.